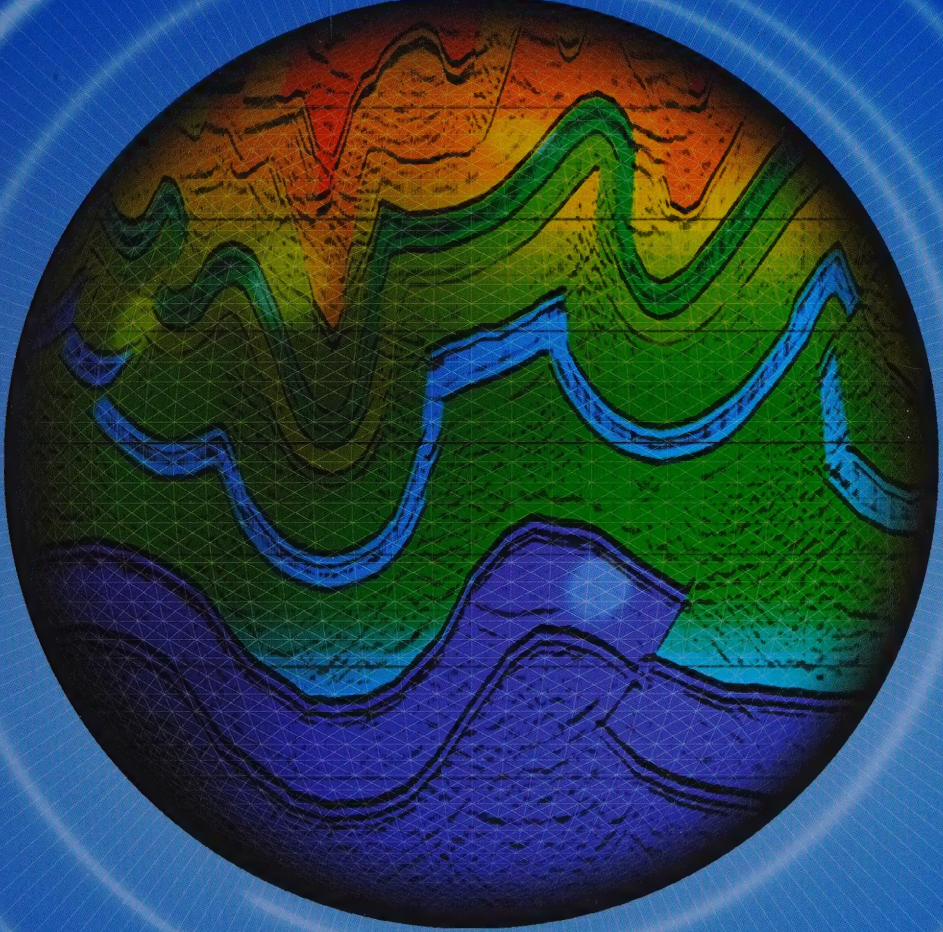
2004 Annual Report



KELMAN TECHNOLOGIES

Kelman Technologies Inc.

ALBANIA ■ ALGERIA ■ ARGENTINA ■ AUSTRALIA
BELIZE ■ BENIN ■ BOLIVIA ■ BRAZIL ■ CAMEROON
CANADA ■ CELTIC ■ SEA ■ CHAD ■ CHINA ■ COLOMBIA
CUBA ■ ECUADOR ■ EGYPT ■ ENGLAND ■ FRANCE
GABON ■ GREENLAND ■ GUATEMALA INDONESIA
IRAN ■ IRAQ ■ IRELAND ■ ISRAEL ■ ITALY ■ JORDAN
KAZAKHSTAN ■ KYRGISTAN ■ LIBYA ■ MEXICO
MOROCCO ■ MYANMAR ■ NEW ZEALAND ■ NORWAY
OMAN ■ PAKISTAN ■ PAPUA NEW GUINEA ■ PERU
PHILIPPINES ■ ROMANIA ■ SENEGAL ■ SEYCHELLES
SIBERIA ■ SPAIN ■ SUDAN ■ SYRIA ■ TANZANIA
TRINIDAD ■ TUNISIA ■ TURKEY ■ USA ■ VENEZUELA
VIETNAM ■ YEMEN

Kelman Technologies Inc., is a publicly traded Canadian technology company with offices in Calgary and Toronto in Canada; Houston, Oklahoma City, and Denver in the United States; and London in the United Kingdom, servicing client companies from 45 countries around the world with a full suite of technology solutions in seismic processing and on-line data archival and data management services. The Company's common shares trade on the Toronto Stock Exchange under the symbol "KTI".

Highlights

- *Hedge of Canadian dollar results in positive cash infusion*
- *Balance sheet very healthy with almost no long-term debt*
- *Data Archives revenue increased 10 percent compared to 2003*
- *Steady & substantial increase in data volumes storage*
- *Oklahoma Processing revenue increased 57 percent*
- *Established presence outside of North America*

Letter to Shareholders

The year 2004 demonstrated continued change in the seismic services industry. While international exploration firmed, activity in North America lagged expectations despite very high commodity pricing. Early in the year when it became apparent that activity levels were down from expectations the Company took steps to reduce overall costs. However, the steps taken were not enough to offset the remarkable decline in activity levels. During the summer period seismic activity in Canada virtually stopped and the backlog the Company carried into the third quarter evaporated quickly without new seismic processing work coming in. In addition, the Houston office failed to meet expectations. There are several reasons for the Houston shortfall but the most significant amongst the factors was a turnover in staff and instability of product quality that arose from the staff turnover.

Our data management business in Canada continued steady with a substantial increase in the amount of data currently under storage. Our Houston data management business experienced significant growth in the volume of data stored, however, activity slowed in the last half of the year because of budget exhaustion in one client and the takeover by a third party of another client.

Despite some setbacks we are pleased that we were able to address many of the factors affecting performance in 2004. Recognizing the shift in exploration activity from North America to the international arena the Company established a new international operating division headed by Mr. Brian Link. This move was followed by the opening of an office in London, UK under the leadership of Dr. Constantine Tsingas, a highly regarded professional in the field. Following a varied marketing and technical representation program the international division was able to be included on bid lists for customers previously unavailable to Kelman and in early 2005 the Company was awarded its first large international contract. In the fourth quarter the Company was able to transfer a long term and highly respected professional from Calgary to head up the Houston Seismic Processing business. Both staff and customers warmly greeted the transfer and that office has been rewarded with an increasing flow of work since his arrival. In the data management business in Houston, which by its nature has a very long sales funnel, the Company actively pursued large US based clients that could generate the volume of business the Company needs to be able to have predictable work volumes. After a series of performance trials and a service level definition meeting the Company was able to secure an increase in data services revenue from one

very large client. Early in 2005 our efforts were rewarded with a long-term master services agreement that should provide the kind of stability the Company needs for this office.

On the corporate level the Company made advancements on several fronts. First, the Company was able to negotiate the renewal of the majority of the convertible preferred shares that expired in November 2004. In so doing the Company was able to remove the redemption of these shares from our current liabilities, thereby greatly improving our working capital. The Company successfully hedged the rise in the Canadian dollar resulting in a positive cash infusion into the Company in early 2005. In addition, our conservative balance sheet remained very healthy and we finished the year with almost no long-term debt.

CORPORATE MATTERS

Prior to the Annual General Meeting ("AGM") in June 2004 Mr. John Butler indicated his desire to not stand for election to an additional term on the Board so that he could pursue his personal business interests in Houston. Mr. Victor Peters, a Toronto based tax lawyer and businessman, replaced Mr. Butler. We thank Mr. Butler for his services and welcome Mr. Peters to the Board of your Company.

Late in the year the Company learned that Mr. David Richard, President and CEO was resigning, effective January 12, 2005, to pursue other opportunities in the exploration and production business. Late in 2004 the Company also learned that for different and unrelated reasons Mr. Blake Lyon, CFO was also resigning effective January 31, 2005. He resigned as a director on January 12, 2005. Each of these gentlemen has made significant contributions to your Company and we thank them for their service.

John A. Paul
President and Corporate Secretary

Processing Division

Calgary

In 2004, due to record high commodity prices, E&P companies spent a disproportionately high percentage of their exploration budgets on drilling. Also in 2004 the other major story continues to be the proliferation of energy trusts, which occurs at approximately 10,000 BPD stage in the life of a junior producer. These two factors generally resulted in less spending on seismic exploration in the Western Canadian Seismic Basin (which is considered a mature basin). In 2004, overall revenues for the seismic processing industry in Calgary fell 9.3 percent even though the amount of seismic records processed was approximately the same as 2003. Price erosion for seismic services continues to be a factor and will likely continue to be for the short term until excess processing capacity is removed from the Canadian market. Two bright spots in Calgary's year were the noteworthy increases in international work and Pre-stack Depth Imaging. International (defined as work from outside of North America by Calgary based companies) increased 22 percent over 2003. Pre-stack Depth Imaging revenues were up 58 percent from 2003 and continue to be a prime area of focus for both our processing and R&D departments. The Company hired a depth migration expert in mid 2004 to help drive our initiatives in this area. This work is coming largely from the difficult areas such as the Mackenzie Delta and the Canadian Foothills in which Kelman has a competitive advantage. International work and the strong demand for Pre-stack Depth Imaging will drive our business into 2005.

Houston

Despite high commodity prices new processing contracts were slow to materialize in Houston as exploration companies directed the majority of their spending to improve deliverability from existing reserves rather than in the search for new reserves. In addition, both management and staff turnover resulted in slow delivery of our products and the output of product that was below our normal professional standard of quality. Each of these factors hurt our ability to make gains in the market. By the summer, demand from the market for land and marine processing increased. To address the situation the Company hired new personnel and sent training and production help from the Calgary office. In October, the Company transferred a highly respected individual with 15 years of KTI experience to manage the Houston processing center. These stabilizing activities were rewarded in the last quarter of the year as clients again became confident in our ability to consistently deliver high quality processing products.

Our new Pre-stack Depth Imaging products in combination with the significant investment in linux processing capacity hardware made in late 2003 were well received resulting in increased revenues in the fourth quarter.

Denver

In 2004, Denver revenues dropped significantly from 2003. In 2003, the Company was awarded a major international contract, which led to substantially higher revenues.

U.S. Rockies exploration started out slow at the beginning of the year but by summer we saw the first signs of increase. The Company transferred an experienced processor from Calgary in anticipation of increased demand for processing services. Late in the year we saw concrete evidence of increased demand as we were awarded a number of new bids. With our reputation for processing data from complex structured regimes, we are well positioned to take advantage of exploration requirements by companies in the Denver area.

Oklahoma

Revenues continued to grow throughout 2004. This growth was fueled by gas exploration in the South Central U.S. by companies operating out of Oklahoma City. To match the growth in this market we have provided assistance from Calgary and are hiring additional professionals. Due to the shortage of experienced processing personnel in the Oklahoma City area, the new hires will come from the Company's other processing offices and they will be transferred once they are fully trained.

Pre-Stack Depth imaging demand increased and these services are currently being provided by the Houston and Calgary offices. The Company expects that the demand for time and depth processing to remain strong in 2005.

Data Management and Archives Division

Canadian Data Management performed close to forecast for 2004. Current client project work, divestitures of large amounts of data under our electronic management and broader service offerings have led to further expansion in our share of the Canadian market.

Houston Data Management hit a lull in the last half of the year due to budget constraints of a major client and the takeover of another US client by a Canadian based client of our services. As with most takeovers this produced an extended period of reduced activity while the merger of the two entities was completed. Resumption of services with both clients is underway for 2005.

As the data volumes grow in the US market we have seen a large increase in data trades from our participating clients that highlights the efficiency and cost savings of true electronic data management. What had previously taken weeks or even months is now being accomplished at our Houston facility in days or hours. It is this type of validation of our service level agreements that will help to propel further adoption of our technology. In conjunction with this the Company has entered into a long-term agreement with a major fiber network provider in Houston in order to increase connectivity to clients and other service providers as time goes on.

Data archived in Calgary and Houston has increased to approximately 90 Terabytes and represents the second straight year of 50 percent growth in data under management and storage. Further enhancements and process developments have been deployed to strengthen our competitive advantage in data management, archiving and online data delivery. Our multi-tiered approach to data storage combined with rigid quality control routines and quick access to all data assets has been well received by the market.

KT International Division

The Canadian and USA hydrocarbon basins are becoming mature. An increasing amount of current and future spending will go to enhanced recovery operations rather than raw exploration efforts. This means that seismic, and therefore, demand for geophysical data processing from these geographic areas is not expected to see the expansion expected internationally. Calgary continues to hold some hope for growth in frontier areas such as East Coast Canada, the Mackenzie Delta and the Northwest Territories. However, this market is also over supplied with service providers that have impacted the pricing of services.

For the last few years E&P companies of all sizes have increasingly turned to international plays. Several countries throughout the world have greatly reduced barriers to attract the E&P investment dollars. Worldwide demand for gas is expected to continue to grow significantly over the next 10 years. Areas previously thought non-economic due to the lack of infrastructure or readily available markets are now gaining more interest. This is due to the building of new infrastructure, an increased number of LNG manufacturing and receiving locations, the possible emergence of gas to liquids technology and an increasing worldwide desire to use a more environmentally friendly source of energy. Worldwide exploration for oil is also expected to be strong and grow as the US desperately tries to develop several possible sources of oil so that it is not so reliant on politically volatile parts of the world.

In the second quarter of 2004, the Company started a new division called Kelman Technologies International. Europe, Africa and Middle East (EAME) areas were targeted for evaluation. It was decided that KT International would establish a coordinating office in London, UK to service the EAME region. Also, a five-year plan was developed that calls for the establishment of several regional offices within the EAME. The London office opened in early 2005 and the Company is now in the process of registering a Branch Office in Tripoli, Libya. In 2005 it is expected that the Company will substantially increase international sales from UK based E&P companies. It is also expected that the rapidly expanding Libyan market will welcome a service provider of the quality of KTI.

Research and Development

R&D efforts at KTI, since 1985 have been aimed at developing a suite of 2D and 3D, land and marine products that are capable of processing data from every part of the world. As a result of this KTI has processed data from virtually every country in the world. KTI has advertised aggressively in worldwide trade magazines such as the Leading Edge for several years and it is well known throughout the world for certain niche areas of processing. Also, over the last 15 years KTI has published over 60 technical papers at various international conventions around the world. KTI currently enjoys an exceptional reputation around the world as a quality service provider, particularly of complex structure land processing services.

Outlook

Our outlook for 2005 is generally positive and based largely on some of the changes made in 2004 and the stability of commodity prices seen throughout the year. Our International Division has already achieved some success and is expected to achieve further successes in 2005. This Division is mandated to not only deliver our services to customers not available to us before but also to pursue new business models such as consulting and training services to national oil companies in Africa and the Middle East. Our Houston office is expected to improve significantly over 2004 because of strong demand for our services, the stability of the new processing leadership and because of the large anchor client we have been seeking for our data management business. The stability of oil and gas commodity during 2004 and its continuation through 2005 is expected to increase 2005 exploration budgets amongst our clients. This should translate into increased seismic business for each of our offices and business divisions.

In addition to the operational risks that always temper an outlook statement our actual results will be heavily dependent upon exploration activity amongst our clients. While at the time of writing all indications continue to be positive for a busier year activity levels could be heavily influenced by commodity pricing, a significant change in the supply/demand balance in oil and by political influences.

Management's Discussion and Analysis

The following Management's Discussion and Analysis has been prepared taking into consideration information available to March 7, 2005, and is supplemental to the consolidated financial statements and related notes contained in this annual report for the year ended December 31, 2004. This discussion and analysis of the financial condition and results of operations has been prepared by management and should be read in conjunction with the accompanying consolidated financial statements and related notes. All amounts in this discussion are expressed in Canadian dollars.

Selected Annual Information

(000s, except per share amounts)	**2004**	2003	2002
Revenue	**$ 21,042**	$ 24,571	$ 28,586
Net earnings (loss)	**$ (2,099)**	$ 459	$ 2,698
Per share (basic and diluted)	**$ (0.05)**	$ 0.01	$ 0.07
Total assets	**$ 16,003**	$ 21,282	$ 22,643
Total long-term debt	**$ 47**	$ 390	$ 3,112

Despite high oil and gas prices, exploration and production activity by our clients was weighted towards exploiting existing reserves, a process that requires less seismic information. Over time the Company still expects the industry to focus on finding new reserves, which will require new seismic information.

Activity levels in 2004 were much lower than expected due to soft domestic markets in Canada and the United States, which resulted in much lower than expected revenues and an operating loss. In 2004 the Company took steps to reduce costs when revenues came in much lower than expected, particularly, in the Company's Houston based processing operations but the steps taken were not enough to offset the lower revenues. In addition, resulting from overall lower U.S.-based processing revenues the Company recognized an impairment loss on goodwill. The impairment loss of $1.1 million increased the reported loss for 2004 and reduced total assets by a like amount.

In 2003 the Company had positive earnings and strong cash flow despite a year of significant expansion and a difficult market environment, particularly in the Company's Houston based operations. Also, during 2003 the Company entered into a forward exchange contract, which expired during the year and resulted in a gain of $913 thousand. In addition, the Company recognized a future income tax asset of $800 thousand in 2003.

In 2002 the Company had positive earnings growth in what was considered a difficult industry environment. Strong sales and expansion in the U.S.-based operations helped the Company achieve earnings that were 22 percent higher than 2001. In addition, the Company recognized a future income tax asset of $1.0 million in 2002.

For the last several years the Company has directed funds towards paying down term debt, which was $8.7 million at December 31, 1998. As at December 31, 2004 the Company had only $47 thousand in long-term debt.

Overview of Operating Results

(000s, except per share amounts)	**2004**	2003	Change
Net earnings (loss)	$ **(2,099)**	$ 459	N/A
Per share (basic and diluted)	$ **(0.05)**	$ 0.01	N/A
Funds from (used in) operations	$ **2,009**	$ 2,492	19%
Weighted average number of shares outstanding (diluted)	**39,533**	40,072	

Net loss for the year ended December 31, 2004 was $2.1 million, a significant decrease from net earnings of $459 thousand achieved in the year ended December 31, 2003. The loss in 2004 is attributed to several factors. In the first and second quarters of 2004 Houston Processing experienced a significant slowdown due to a soft domestic market and operational issues. In addition, there was a temporary slowdown in the Calgary Processing market during August and September 2004. In the third and fourth quarters of 2004 Houston Archives experienced a significant slowdown in work with a major client due to budgetary constraints. In 2003 Denver Processing was awarded and completed a US $1.7 million contract for a client. This contract along with other contracts that were completed for clients during 2003 led to earnings of $986 thousand. Denver Processing was not awarded a contract of this magnitude in 2004, which led to a net loss of $255 thousand, $1.2 million lower than 2003. In addition, the Company recognized an impairment loss relating to goodwill for the U.S.-based Seismic Processing operations. All of these factors contributed to the net loss in 2004.

Funds from operations for the year ended December 31, 2004 were $2.0 million, a decrease of $483 thousand from $2.5 million generated in 2003. Per share loss (basic and diluted) for the year ended December 31, 2004 was $0.05 compared to per share earnings of $0.01 in 2003. Per share figures are based on the weighted average shares outstanding of 39,533,141 (diluted) during the year ended December 31, 2004 compared to 40,071,950 (diluted) in 2003.

Net loss for the quarter ended December 31, 2004 was $1.4 million including the recognition of the $1.1 million impairment loss related to goodwill, a significant increase from the loss of $78 thousand in the comparable period in 2003. The loss during the fourth quarter is attributed to the slowdown in work awarded to Houston Archives and Denver Processing divisions in 2004.

Funds from operations for the quarter ended December 31, 2004, were $148 thousand, a significant increase over negative funds of $150 thousand for the comparable period in 2003. Per share loss (basic and diluted) in the fourth quarter of 2004 was $0.04 compared to $0.00 in the comparable period in 2003. Per share figures are based on the weighted average shares outstanding of 39,886,005 (diluted) during the fourth quarter of 2004 compared to 40,056,764 (diluted) during the comparable period in 2003.

Operating Revenue

(000s)	2004	2003	Change
Seismic Processing			
Canada	$ 9,958	$ 10,307	(3)%
United States	4,805	8,538	(44)%
	$ 14,763	$ 18,845	(22)%
Data Archiving			
Canada	$ 5,028	$ 4,941	2%
United States	1,251	785	59%
	$ 6,279	$ 5,726	10%
Total operating revenue	$ 21,042	$ 24,571	(14)%

Seismic Processing revenue for the year ended December 31, 2004 of $14.8 million decreased 22 percent from $18.8 million in 2003, due to lower sales in Calgary, Houston and Denver as previously mentioned in the Overview of Operating Results. In the year ended December 31, 2004, Calgary Seismic Processing revenue of $10.0 million decreased 3 percent from $10.3 million in 2003. Houston Processing revenue of $2.2 million decreased 52 percent from $4.5 million in 2003. Denver Processing revenue of $1.4 million decreased 59 percent from $3.3 million in 2003. Oklahoma Processing revenue of $1.2 million increased 57 percent from $764 thousand in 2003. Foreign-sourced revenue of $5.6 million represents 38 percent of total processing revenue for the year ended December 31, 2004, a decrease from $9.5 million representing 51 percent of total processing revenue in 2003.

In the year ended December 31, 2004, Data Archives revenue of $6.3 million increased 10 percent compared to $5.7 million in 2003. At the end of fiscal 2003 Houston Archives had an influx of data, which resulted in increased revenues during the first five months of fiscal 2004 but revenues in this market dropped significantly throughout the balance of the year when a major client experienced budgetary constraints and there were no new major clients to offset this lost revenue stream.

Seismic Processing revenue for the quarter ended December 31, 2004 of $3.8 million decreased 10 percent from $4.2 million for the comparable period in 2003, due to lower sales. In the quarter ended December 31, 2004, Calgary Seismic Processing revenue of $2.3 million increased 1 percent from $2.3 million in the comparable period in 2003. Houston Processing revenue of $822 thousand decreased 7 percent from $882 thousand in the comparable period in 2003. Denver Processing revenue of $273 thousand decreased 63 percent from $732 thousand in the comparable period in 2003. Oklahoma Processing revenue of $356 thousand increased 34 percent from $266 thousand in the comparable period in 2003. Foreign-sourced revenue of $1.6 million represents 42 percent of total processing revenue for the fourth quarter, a decrease from $2.2 million for the comparable period in 2003. The order backlog for seismic processing services at December 31, 2004 was $3.7 million, up significantly from $2.0 million in the comparable period in 2003.

In the quarter ended December 31, 2004, Data Archives revenue of $1.4 million increased 3 percent from the comparable period in 2003. Calgary Archives revenue of $1.3 million increased 18 percent from $1.1 million in the comparable period in 2003. Houston Archives revenue of $162 thousand decreased 40 percent from $270 thousand in the comparable period in 2003. The order backlog for data management and archives services was $1.8 million, down slightly from $1.9 million in the comparable period in 2003.

Operating Expenses

(000s)	2004	2003	Change
Operating expenses	$ **18,332**	$ 20,739	(12)%

In the year ended December 31, 2004 the Processing Division operating expenses were $13.3 million, a 17 percent decrease from $16.0 million in 2003. The decrease in operating expenses is mainly attributed to expense and staffing reductions implemented early in the year as a result of reduced revenues. The Company continues to take steps to reduce costs while sales recover.

In the year ended December 31, 2004 the Archives Division operating expenses were $5.0 million, an 8 percent increase from $4.7 million in 2003. The increase in operating expenses is attributed to expansion in the Houston market. Operating expenses for Houston Archives increased 56% from $1.3 million in 2003 to $2.1 million in 2004.

In the quarter ended December 31, 2004 the Processing Division operating expenses were $3.6 million, a 14 percent decrease from $4.1 million in the comparable period in 2003. The decrease in operating expenses is mainly attributed to expense and staffing reductions implemented early in the year as a result of reduced revenues particularly in the Houston market.

In the quarter ended December 31, 2004 the Archives Division operating expenses were $1.1 million, a 9 percent decrease from $1.3 million in the comparable period in 2003. The decrease in operating expenses is mainly attributed to expense and staffing reductions implemented.

Depreciation and Amortization

(000s)	2004	2003	Change
Depreciation and amortization	$ **3,269**	$ 3,573	(9)%

Depreciation and amortization expense for the year ended December 31, 2004 was lower than the year ended December 31, 2003 due to decreased capital expenditures in 2004. As a result of lower than expected sales the Company limited the purchase of capital expenditures to critical expenditures only.

In the quarter ended December 31, 2004 depreciation and amortization expense was $790 thousand, a decrease of 16 percent from $939 thousand in the comparable period in 2003. Capital expenditures in the quarter were $302 thousand, down 68 percent from $932 thousand in the comparable period in 2003.

Interest and Dividends

(000s)	2004	2003	Change
Interest on short-term debt	$ **145**	$ 95	53%
Interest on long-term debt	**10**	175	(95)%
Preferred share dividends	**326**	330	(1)%
Total interest and dividends	$ **481**	$ 600	(20)%

Interest on short-term debt increased as a result of fees associated with new banking arrangements entered into during the second quarter of 2004. Interest on long-term debt decreased as a result of lower debt outstanding during the year. Most of the interest expense in the current year is related to dividends on the Company's Preferred Shares. Given that the Preferred Shares are subject to prescribed redemption, accounting rules dictate that dividends thereon are classified as interest expense.

Income Taxes

The Company has an unrecognized net future income tax asset totaling $13.2 million. This asset can be used to reduce taxable income in the next several years. The Canadian division has $1.3 million of non-capital losses that expire in 2006. To the extent that certain deductions from taxable income are discretionary, notably with respect to capital assets, the Company has the option of refiling prior year income tax returns so as to accelerate the availability of non-capital loss carryforwards. The US division has US$13.9 million in net operating losses expiring at various times until 2024.

Working Capital and Cash Balances

(000s)		**2004**		2003	Change
Working capital before preferred shares	$	**4,389**	$	5,376	(19)%
Preferred shares (included as a current liability)	$	**(605)**	$	(5,075)	N/A
Working capital	$	**3,784**	$	301	94%
Cash position	$	**230**	$	(1,474)	N/A

Cash continued to be directed primarily to expansion activities, capital additions and paying down debt during the year ended December 31, 2004.

Capital expenditures in the year ended December 31, 2004 were controlled to $2.0 million, a decrease of 35 percent from $3.0 million in 2003.

Capital expenditures in the quarter ended December 31, 2004 were $302 thousand, a decrease of 68 percent from $932 thousand in the comparable period in 2003.

The Company decreased the draw against its line of credit by $1.4 million.

Liquidity and Capital Resources

(000s)		**2004**		2003	Change
Total term debt outstanding	$	**–**	$	245	(100)%
Total capital leases outstanding		**47**		145	(68)%
Total debt	$	**47**	$	390	(88)%

Total term debt decreased by $245 thousand. During the year there were no additions to term debt.

The Company has a credit facility with it's bank consisting of a demand bank operating line of credit of $5,000,000 or its US equivalent and a 364 day committed extendible revolver of $4,000,000 or its US equivalent available at the Company's option by way of a fixed rate term loan in Canadian dollars or a floating rate term loan available by way of: a) prime rate based loans in Canadian dollars or b) United States base rate loans in US dollars. The 364 day committed extendible revolver is only available upon compliance with a number of terms and conditions of the bank. The long-term debt facility that is available to the Company remained unused as of December 31, 2004.

The Company's contractual obligations include one capital lease for computer equipment, which is due within one year. The total amount of the capital lease outstanding as at December 31, 2004 was $47 thousand.

The Company expects to fund capital expenditures and expansion in 2005 through normal cash flow, and bank operating lines.

In 2004 the Company completed an offer to holders of the Kelman Series A Convertible Preferred Shares, which expired ("Expiring Shares") on November 5, 2004 to exchange the Expiring Shares for a new class of Series B Convertible Preferred Shares with a five-year term ("New Shares") at an exchange ratio of 1.3095

New Shares for each Expiring Share. Pursuant to this offer the holders of 92 percent of the Expiring Shares elected to exchange their shares for New Shares on November 5, 2004.

The New Shares are priced at $0.50 and each will be convertible, at the option of the holder, into one common share and a payment of $0.08 at any time prior to expiry. The New Shares will carry a dividend rate of 7.25 percent and under certain conditions the Company will have the right to make the $0.08 payment on conversion in the form of common shares. The $0.08 amount that could be payable has been included in current liabilities on the balance sheet.

Under the rules of the Toronto Stock Exchange (TSX) insiders who elected to exchange their shares were restricted to a maximum of 7,264,315 New Shares. Accordingly, after the exchange, Seyco Operations Ltd., a company related to the Company's major shareholder, holds 6,861,392 New Shares, other insiders hold 402,923 and non-insiders hold 302,193. The Expiring Shares which were not exchanged or which could not be exchanged because of the TSX restriction were redeemed for cash on November 5, 2004. The redemption totaling $1.3 million was funded from existing cash balances and/or bank operating lines of credit.

Off-Balance Sheet Arrangements

The Company maintains a conservative balance sheet and has no investments in any off-balance sheet ventures such as partnerships or joint ventures. During 2004 the Company entered into a forward exchange contract, which expired on January 18, 2005 and resulted in a gain of $421,000.

Goodwill

Goodwill represents the excess of the purchase price over the net identifiable assets on acquisitions and was amortized, up to December 31, 2001, on a straight-line basis over five years. The value of the residual unamortized balance is assessed annually with reference to various factors, principally the projected future cash flows of the business to which the goodwill relates.

Goodwill arose from the acquisition of all of the issued and outstanding shares of Seismic Data Processors, Inc., a United states corporation operating in the seismic data processing business. The acquisition was accounted for using the purchase method with results of operations being included from the date of acquisition. Goodwill was amortized up to December 31, 2001.

On an annual basis goodwill is tested for impairment. The segment used to test for impairment is the US-based processing operations. The U.S.-based processing operations had a loss of $2.3 million in 2004. The impairment test revealed the carrying value of the U.S.-based operations was higher than the fair value of the U.S.-based operations therefore, the Company recognized an impairment loss of $1.1 million in 2004.

Related Party Transactions

The majority of the preferred shares are held by a company related to the Company's major shareholder. For the year ended December 31, 2004, dividends paid in this regard amounted to $278,905 in 2004 and $281,125 in 2003.

In the year ended December 31, 2004 fees of $52,545 (2003 - $39,595) were paid to a company related to the Company's major shareholder for accounting services provided.

Changes in Accounting Policies

There have been no changes in accounting policies, which affect the December 31, 2004 consolidated financial statements.

Critical Accounting Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of these annual financial statements and the reported amounts of revenue and expenses during the reporting period.

Revenue is recorded using the percentage-of-completion method and is based upon completing certain measurable stages of customer projects. Work in progress is recorded at the lower of cost and estimated net realizable value.

Depreciation expense is recorded using the declining-balance and the straight-line methods and is based upon allocating the cost of property and equipment less any salvage value (if any) over the estimated service life which may differ from physical life.

Share Capital Summary

The following table provides details of the Company's issued and outstanding shares for the periods ended December 31, 2004 and December 31, 2003.

	2004	2003
Weighted average shares outstanding:		
Basic	**39,533,141**	39,174,341
Diluted	**39,533,141**	40,071,950
Shares outstanding at period end	**39,569,721**	39,473,122

At December 31, 2004 there were 3,097,301 (4,240,180 - 2003) stock options outstanding at exercise prices ranging from $0.25 to $0.65.

At March 7, 2005 there were 39,569,721 Common Shares and 3,290,801 stock options outstanding.

Financial Summary of Quarterly Results ($000's Except Per Share Data)

			2004				2003	
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Seismic								
Processing Revenue	**3,776**	**3,046**	**4,114**	**3,827**	4,176	5,631	4,968	4,070
Archives Revenue	**1,437**	**1,441**	**1,816**	**1,585**	1,399	1,316	1,469	1,542
Total Revenue	**5,213**	**4,487**	**5,930**	**5,412**	5,575	6,947	6,437	5,612
Net Earnings (loss)	**(1,437)**	**(935)**	**409**	**(136)**	(78)	835	645	(943)
Per Share								
(basic and diluted)	**(0.04)**	**(0.02)**	**0.01**	**0.00**	0.00	0.02	0.02	(0.02)

In the fourth quarter of 2004 seismic processing revenues increased 24 percent over the third quarter as a result of significantly higher revenues in the Calgary and Houston based operations. The loss at the end of the fourth quarter increased as a result of the impairment loss on goodwill that was recognized at December 31, 2004. In the third quarter of 2004 seismic processing revenues decreased 26 percent over the second quarter as a result of significantly lower revenues in the Calgary processing market in August and September. The overall market came to a virtual standstill and also became very price competitive. In addition, in the third quarter Archives revenues dropped substantially from the second quarter when a major Houston based client experienced budgetary constraints and another client was acquired. In the second quarter of 2004 Calgary processing revenue increased 14 percent over the first quarter. The increase in the second quarter follows the

usual trend expected for the Calgary processing market. In addition, Archives revenues increased as a result of an influx of work, in particular in the Houston based operations. In the first quarter of 2004 Houston based processing revenues decreased by 59 percent as a result of a very tight market as well as quality and delivery problems. Houston Archives had an influx of work from a major client, which led to increased revenues in the first quarter of 2004.

In the fourth quarter of 2003 seismic processing revenues decreased 26 percent over the third quarter as a result of significantly lower revenues in the Denver and Houston based operations. Revenues for Denver were down substantially from the third quarter of 2003. Revenues for a major international project were recognized in the third quarter. Year 2003 over year 2002 Denver experienced growth resulting in an increase of 141 percent in revenues. Houston processing revenues were starting to drop as a result of quality and delivery problems. Houston Archives revenues were slowly increasing as work started to flow in from clients during the fourth quarter. In the third quarter of 2003 seismic processing revenues increased 13 percent over the second quarter as a result of significantly higher revenues. Denver recognized revenues of US $1.2 million on a major international project. Calgary processing revenues were down substantially as per the usual trend for the third quarter. In the second quarter of 2003 Calgary processing revenues increased 27 percent over the first quarter. The increase in the second quarter follows the usual trend expected for the Calgary processing market, as previously mentioned. Also in the second quarter, Calgary Archives revenues dropped due to the seasonal slowdown in the market but greater efficiencies were gained from software enhancements. In the first quarter of 2003 Houston based processing revenues decreased by 43 percent as a result of sales that were far below expectations. Houston Archives operations slowed through the first quarter of 2003 when two main projects were delayed until the second quarter, which led to lower than expected revenues for the quarter.

Risks and Uncertainties

The Company is engaged in seismic data processing and seismic data management. The demand for these services is somewhat dependent upon the level of expenditures in the exploration and production segment of the oil and gas industry. These expenditures are influenced primarily by the price of the commodity being produced. The Company is also subject to risk and uncertainty related to technological advances and direct competition within the data processing and data archival sectors.

With a continued commitment to product enhancement and value-added customer service the Company attempts to minimize risk in the seismic data processing realm by offering a sophisticated suite of proprietary products, applications in land and marine processing to customers located in countries around the world.

The Company's state of the art data management and archival line of business is not as directly affected by fluctuations in exploration activity. A flexible open system to meet client's specific needs provides an economical solution to seismic data storage, retrieval and management and as such is less dependent on capital exploration budgets. The Company has created residual revenues through long-term working relationships with clients, which help to minimize short-term volatility in the market.

Forward-Looking Statements

In addition to historical information, this report contains statements which by their nature are forward-looking and which involve known and unknown risks, delays, uncertainties and other factors not under the Company's control. Any of these factors may cause actual results, performance or achievement to be materially different from the results, performance or expectation implied by these forward-looking statements.

Other information about the Company can be found on SEDAR or on the Company's Website: www.kelman.com.

Management's Report

The accompanying consolidated financial statements of Kelman Technologies Inc. and all information in the annual report were prepared by and are the responsibility of management. The consolidated financial statements have been prepared in accordance with accounting policies outlined in the notes to the consolidated financial statements and in conformity with the Canadian generally accepted accounting principles.

Management maintains appropriate systems of internal controls designed to provide reasonable assurance that all transactions are appropriately authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The consolidated financial statements have been examined in accordance with generally accepted auditing standards in Canada by the independent accounting firm KPMG LLP whose appointment is ratified annually by the shareholders at the annual shareholders' meeting.

The Audit Committee of the Board of Directors, which is comprised exclusively of directors who are not employees of the Company, has reviewed the consolidated financial statements, including the notes thereto, with management and KPMG. The Board of Directors approved the consolidated financial statements on the recommendation of the Audit Committee.

John Paul	Seymour Epstein	Debbie Garbutt
President	Chairman & CEO	CFO

March 7, 2005

Auditor's Report

We have audited the consolidated balance sheets of Kelman Technologies Inc. as at December 31, 2004 and 2003 and the consolidated statements of operations, deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 7, 2005

As at December 31	2004	2003
Assets		
Current assets:		
Cash	$ 730,436	$ 451,473
Accounts receivable	4,271,953	7,878,823
Work in progress	1,285,836	772,226
Prepaid expenses and deposits	341,451	433,086
	6,629,676	9,535,608
Property and equipment (note 2)	7,516,582	8,692,316
Goodwill (note 3)	–	1,060,110
Other assets (note 4)	56,403	194,287
Future income tax asset (note 5)	1,800,000	1,800,000
	$ 16,002,661	$ 21,282,321
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness (note 6)	$ 500,000	$ 1,925,186
Accounts payable and accrued liabilities	1,693,626	1,893,760
Current portion of long-term debt (note 6)	46,608	340,361
Preferred shares (note 7)	605,321	5,075,000
	2,845,555	9,234,307
Long-term debt (note 6)	–	49,865
Preferred shares (note 7)	2,508,668	–
Shareholders' equity:		
Share capital (note 8)	12,609,071	12,603,232
Equity component of preferred shares (note 7)	641,819	–
Contributed surplus (note 8)	416,578	315,000
Deficit	(3,019,030)	(920,083)
	10,648,438	11,998,149
Commitments (note 9)		
	$ 16,002,661	$ 21,282,321

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Seymour Epstein
Director

Paul Watson
Director

Consolidated Statements of Operations

Years ended December 31,	2004	2003
Revenue	$ 21,041,973	$ 24,570,924
Expenses:		
Operating	18,331,635	20,739,164
Depreciation and amortization	3,268,589	3,573,014
Impairment loss	1,060,110	–
Interest	480,586	600,134
	23,140,920	24,912,312
Loss before income taxes	(2,098,947)	(341,388)
Income taxes, future reduction (note 5)	–	800,000
Net earnings (loss)	$ (2,098,947)	$ 458,612
Net earnings (loss) per Common Share, basic and diluted	$ (0.05)	$ 0.01

Consolidated Statements of Deficit

Years ended December 31,	2004	2003
Balance, beginning of year	$ (920,083)	$ (1,378,695)
Net earnings (loss)	(2,098,947)	458,612
Balance, end of year	$ (3,019,030)	$ (920,083)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31,	2004	2003
Cash provided by (used in):		
Operations:		
Net earnings (loss)	$ (2,098,947)	$ 458,612
Items not involving cash:		
Depreciation and amortization	3,268,589	3,573,014
Impairment loss	1,060,110	–
Unrealized foreign exchange gain	(416,594)	(862,504)
Future income taxes, recovery	–	(800,000)
Stock-based compensation expense	107,417	215,000
Deferred finance charges	55,868	–
Gain on settlement of note receivable	–	(106,035)
Loss on disposal of property and equipment	32,781	14,109
Funds from (used in) operations	2,009,224	2,492,196
Change in non-cash working capital items	3,401,355	1,501,820
	5,410,579	3,994,016
Financing:		
Repayment of long-term debt	(343,618)	(3,052,619)
Repayment of preferred shares	(1,319,192)	–
Increase (decrease) in bank indebtedness	(1,425,186)	682,155
Repayment of note receivable	–	448,541
Long-term debt		330,529
Deferred finance charges	(112,271)	–
	(3,200,267)	(1,591,394)
Investing:		
Expenditures on property and equipment	(1,956,349)	(3,005,024)
Proceeds on disposal of property and equipment	25,000	–
	(1,931,349)	(3,005,024)
Increase (decrease) in cash	278,963	(602,402)
Cash, beginning of year	451,473	1,053,875
Cash, end of year	$ 730,436	$ 451,473
Supplemental information:		
Interest paid	$ 465,208	$ 597,513
Interest received	$ 13,913	$ 8,566

See accompanying notes to consolidated financial statements.

Years ended December 31, 2004 and 2003

1. *Significant accounting policies:*

(a) Basis of presentation:
These financial statements include the accounts of the Company and those of its subsidiaries, all of which are wholly owned.

(b) Use of estimates and assumptions:
The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

(c) Foreign currency translation:
Foreign-denominated monetary assets and liabilities are translated at the exchange rate prevailing at the balance sheet date. Revenue and expenses, other than depreciation and amortization, are translated at average rates of exchange during the period. Non-monetary assets and liabilities are translated at the exchange rate in effect at the date of the transaction. Exchange gains and losses arising on the translation of monetary assets and liabilities are recorded in operations.

(d) Revenue recognition:
Revenue is recorded using the percentage-of-completion method and is based upon achieving certain measurable stages of customer projects. Work in progress is recorded at the lower of cost and estimated net realizable value.

(e) Property and equipment:
Property and equipment is recorded at cost. Depreciation is provided as follows:

Computer hardware	25% declining-balance
Computer software	3 years straight-line
Equipment and furniture	5 years straight-line
Leasehold improvements	5 years straight-line

Computer software includes development costs related to specific products or processes that are proven to be technically and economically feasible. Depreciation thereof commences at the time of capitalization. All research costs are charged to operations in the period incurred.

(f) Goodwill:
Goodwill represents the excess of the purchase price over the net identifiable assets on acquisitions and was amortized, up to December 31, 2001, on a straight-line basis over five years. The value of the residual unamortized balance is assessed at least annually with reference to various factors, principally the projected future cash flows of the businesses to which the goodwill relates.

(g) Deferred costs:
Deferred costs relate to the start-up of a new business operation and to a project previously completed. Amortization was calculated on a straight-line basis over three years and is included in depreciation and amortization in the statements of operations.

(h) Deferred finance charges:
Deferred finance charges relate to the new banking arrangements entered into in the second quarter and the new class of Series B Convertible Preferred Shares that are classified as long-term liabilities. Amortization of the deferred finance charges for the new banking arrangements is calculated on a straight-line basis over one year. Amortization of the deferred finance charges for the new class of Series B Convertible Preferred Shares is calculated on a straight-line basis over five years.

(i) Income taxes:
The Company provides for income taxes using the asset and liability method. Under this method current income taxes are recognized for the estimated income taxes payable for the current year and future income taxes are recognized for temporary differences between the tax and accounting bases of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are considered more likely than not to be realized. Future income tax assets and liabilities are measured using tax rates expected to apply in the years in which temporary differences are expected to

be recovered or settled. Any change to the net future income tax asset or liability is included in operations in the year it occurs.

(j) Diluted per share amounts:

Diluted per share amounts are computed using the "treasury stock" method whereby outstanding stock options and share purchase warrants are only dilutive if, and to the extent that, they are "in the money".

(k) Stock-based compensation:

The Company adopted effective January 1, 2002 new financial accounting requirements with respect to stock-based compensation.

The Company accounts for its "market growth options" as equity instruments awarded to employees and determines compensation expense based on the fair value of the option on the grant date. Compensation expense is recognized over the expected life of the option.

(l) Cash:

Cash represents highly liquid short term deposits with original maturities of 90 days or less.

2. *Property and equipment:*

December 31, 2004	Cost	Accumulated depreciation	Net book value
Computer hardware	$ 22,039,688	$ 17,084,220	$ 4,955,468
Computer software	18,124,698	15,758,845	2,365,853
Equipment and furniture	834,605	741,979	92,626
Leasehold improvements	590,566	487,931	102,635
	$ 41,589,557	$ 34,072,975	$ 7,516,582

December 31, 2003	Cost	Accumulated depreciation	Net book value
Computer hardware	$ 21,844,478	$ 15,562,735	$ 6,281,743
Computer software	16,580,472	14,386,763	2,193,709
Equipment and furniture	811,611	705,711	105,900
Leasehold improvements	538,461	427,497	110,964
	$ 39,775,022	$ 31,082,706	$ 8,692,316

Included in computer hardware is certain equipment under capital lease with a net book value of $66,976 at December 31, 2004 ($257,591 at December 31, 2003).

Included in computer software is capitalized development costs of $1,157,790 at December 31, 2004 ($953,850 at December 31, 2003).

3. *Goodwill:*

	2004	2003
Goodwill	1,060,110	1,060,110
Impairment loss	1,060,110	–
	$ –	$ 1,060,110

Goodwill arose from the acquisition of all of the issued and outstanding shares of Seismic Data Processors, Inc., a United states corporation operating in the seismic data processing business.

The acquisition was accounted for using the purchase method with results of operations being included from the date of acquisition. Goodwill was amortized up to December 31, 2001.

On an annual basis goodwill is tested for impairment. The segment used to test for impairment is the US-based processing operations. The US-based processing operation's carrying value was in excess of the fair value, therefore, the Company recognized an impairment loss of $1,060,110 in 2004.

4. *Other assets:*

	2004	2003
Deferred costs	–	194,287
Deferred finance charges	56,403	–
	$ 56,403	$ 194,287

(a) Deferred costs:

	2004	2003
Cost	$ 1,275,069	$ 1,275,069
Accumulated amortization	1,275,069	1,080,782
Net book value	$ –	$ 194,287

(b) Deferred finance charges:

	2004	2003
Cost	$ 112,271	$ –
Accumulated amortization	55,868	–
Net book value	$ 56,403	$ –

5. *Income taxes:*

Income tax expense differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rate to the earnings before income taxes. The reasons for the differences are as follows:

	2004	2003
Loss before income taxes	$ (2,098,947)	$ (341,388)
Combined Federal and Provincial statutory rate	33.87%	36.75%
Computed expense (recovery)	$ (710,913)	$ (125,460)
Increase (decrease) resulting from:		
Recognized benefit of future income tax assets	200,261	(1,168,481)
Non-deductible expenses	197,788	259,173
Change in enacted tax rates	318,420	159,150
Adjustment for foreign income tax rate	(5,556)	75,618
Actual reduction	$ –	$ (800,000)

The components of the future income tax asset at December 31, 2004 are as follows:

	Canada	United States	Total
Non-capital/net operating losses	$ 448,000	$ 5,832,000	$ 6,280,000
Capital losses	4,249,000	–	4,249,000
Capital assets	2,580,000	(224,000)	2,356,000
Other	568,000	(293,000)	275,000
	$ 7,845,000	$ 5,315,000	$ 13,160,000
Less valuation allowance	6,045,000	5,315,000	11,360,00
Future income tax asset	$ 1,800,000	$ –	$ 1,800,000

The components of the future income tax asset at December 31, 2003 are as follows:

	Canada	United States	Total
Non-capital/net operating losses	$ 460,000	$ 4,988,000	$ 5,448,000
Capital losses	4,375,000	–	4,375,000
Capital assets	3,693,000	(316,000)	3,377,000
Other	1,464,000	98,000	1,562,000
	$ 9,992,000	$ 4,770,000	14,762,000
Less valuation allowance	8,192,000	4,770,000	12,962,000
Future income tax asset	$ 1,800,000	$ –	$ 1,800,000

The non-capital and net operating loss carryforwards reflected above expire as follows:

Canada		Non-capital losses
2006	$	1,329,000

United States		Net operating losses
2009	U.S. $	2,500,000
2010		1,200,000
2011		2,300,000
2019		300,000
2020		2,000,000
2021		830,000
2022		160,000
2023		1,650,000
2024		2,980,000
	U.S. $	13,920,000

6. *Bank credit facility and long-term debt:*

The Company's banking arrangements consist of a demand bank operating line of credit of $5,000,000 or its US equivalent and a 364 day committed extendible revolver of $4,000,000 or its US equivalent available at the Company's option by way of a fixed rate term loan in Canadian dollars or a floating rate term loan available by way of: a) prime rate plus 1% to 1.25% in Canadian dollars or b) United States base rate loans plus 1% to 1.25% in US dollars. The 364 day committed extendable revolver is only available upon compliance with a number of terms and conditions of the bank. All bank borrowings are secured by a general security agreement ("GSA") representing a first charge on all the Company's assets and undertaking.

Long-term debt consists of the following:

		2004		2003
Bank term loan, due in monthly instalments of $73,333, with interest at prime plus 1.90% to 2.15% depending on fixed coverage ratio; matured in April 2004	**$**	**–**	$	245,603
Capital leases, due in monthly instalments of $11,482 including interest, maturing in 2004 through 2005, bearing interest at a weighted average rate of 10.0%		**46,608**		144,623
		46,608		390,226
Less current portion, included in current liabilities		**46,608**		340,361
	$	**–**	$	49,865

Scheduled repayments of long-term debt are as follows:

2005	$	46,608

Interest paid on long-term debt during the years ended December 31, 2004 and 2003 amounted to $19,315 and $175,236, respectively.

7. *Preferred shares:*

During the third quarter of 2004 the Company completed an offer to holders of the Kelman Series A Convertible Shares, which expired ("Expiring Shares") on November 5, 2004 to exchange the Expiring Shares for a new class of Series B Convertible Preferred Shares with a five-year term ("New Shares") at an exchange ratio of 1.3095 New Shares for each Expiring Share. Pursuant to this offer the holders of 92 percent of the Expiring Shares elected to exchange their shares for New Shares.

Preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature which is included as part of shareholder's equity.

The New Shares are priced at $0.50 and each will be convertible, at the option of the holder, into one common share and a payment of $0.08 at any time prior to expiry. The New Shares carry a fixed dividend rate of 7.25 percent and under certain conditions the Company will have the right to make the $0.08 payment on conversion in the form of common shares. The dividends are cumulative. Given that the New Shares are convertible at the option of the holder any time prior to expiry the $0.08 payment amount per share has been classified as a current liability.

Under the rules of the Toronto Stock Exchange (TSX) insiders who elected to exchange their shares were restricted to a maximum of 7,264,315 New Shares. Accordingly, after the exchange, Seyco Operations Ltd., a company related to the Company's major shareholder, holds 6,861,392 New Shares, other insiders hold 402,923 and non-insiders hold 302,193. The Expiring Shares which were not exchanged or which could not be exchanged because of the TSX restriction were redeemed for cash on November 5, 2004. The redemption amount paid was $1,319,192.

Dividends of $41,777 were paid in 2004 on the new class of Series B Convertible Preferred Shares and dividends of $283,743 and $329,875 were paid in each of 2004 and 2003 on the Series A Convertible Shares. Dividends have been included in interest expense in the statements of operations.

8. *Share capital:*

(a) Authorized:
Unlimited number of Common Shares

Unlimited number of Senior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

Unlimited number of Junior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

(b) Issued:

	Number of Common Shares	Amount
Balance, December 31, 2002	39,110,296	$ 12,603,232
Issued on exercise of options	368,798	–
Cancelled on surrender of shares	(5,972)	–
Balance, December 31, 2003	39,473,122	12,603,232
Issued on exercise of options	97,749	–
Conversion of options	–	5,839
Cancelled on surrender of shares	(1,150)	–
Balance, December 31, 2004	**39,569,721**	**$ 12,609,071**

(c) Options:
The Company has a share option plan under which employees, officers and directors are eligible to receive options to acquire Common Shares, subject to a limit of 6.8 million shares. The options vest immediately or up to a period of either 3 or 4 years with expiry terms of 4 or 5 years. At December 31, 2004 the number of options outstanding was 3,097,301 at prices ranging from $0.25 to $0.65 per share and expiring on various dates to November 15, 2008. Changes in options are summarized as follows:

	2004		2003	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
Outstanding, beginning of year	**4,240,180**	**$ 0.51**	5,823,531	$ 0.54
Granted	**110,000**	**0.47**	300,000	0.54
Exercised	**(340,655)**	**0.36**	(1,166,318)	0.37
Cancelled	**(912,224)**	**0.50**	(717,033)	0.70
Outstanding, end of year	**3,097,301**	**$ 0.54**	4,240,180	$ 0.51
Exercisable, end of year	**2,440,443**	**$ 0.53**	2,626,689	$ 0.51

The following table summarizes information regarding the options outstanding at December 31, 2004:

	Options outstanding			Options exercisable	
Range of exercise prices	Weighted average remaining life	Number	Weighted average exercise price	Number	Weighted average exercise price
$0.25 to $0.50	14 months	907,677	$ 0.39	767,671	$ 0.38
$0.51 to $0.65	24 months	2,189,624	$ 0.60	1,672,772	$ 0.60
$0.25 to $0.65	16 months	3,097,301	$ 0.54	2,440,443	$ 0.53

All of the 3,097,301 options outstanding are in the form of "market growth options" whereby the option holder makes no payment to the Company but instead receives a reduced number of Common Shares, calculated in relation to the difference between the current market price of the shares and the exercise price thereof. During 2004, 340,655 options (2003 – 1,166,318) were converted into 97,749 common shares (2003 - 368,798).

The weighted average fair value of stock options granted during the year was $0.47 on the grant date using the Black-Scholes option pricing model with the following weighted assumptions: risk-free interest rate of 2.29 percent, expected life of four years, expected volatility of 56 percent, forfeiture rate 30 percent and expected dividend yield of 0 percent. The Company recognized compensation expense of $107,417 for stock-based employee compensation awards with a corresponding recognition of contributed surplus during 2004. The corresponding amount was $215,000 in 2003.

(d) Contributed surplus:

	2004	2003
Opening balance, December 31	$ **315,000**	$ 100,000
Additions to contributed surplus	**107,417**	215,000
Conversion of options	**(5,839)**	–
Closing balance, December 31	$ **416,578**	$ 315,000

(e) Warrants:

At December 31, 2004 and December 31, 2003 there were warrants outstanding with a former debenture holder to acquire 3,090,534 Common Shares at prices ranging from $0.41 to $1.92, expiring on various dates to June 5, 2006.

(f) Per share information:

The following table summarizes the common shares used in calculating net earnings (loss) per common share:

	2004	2003
Weighted average number of common shares outstanding - basic	**39,533,141**	39,174,341
Effect of dilutive employee stock options and warrants	**–**	897,609
Weighted average number of common shares outstanding – diluted	**39,533,141**	40,071,950

For the year ended December 31, 2004, a total of 316,284 options and warrants were not included in the calculation of dilutive potential common shares as the result would be anti-dilutive.

9. *Commitments:*

Future minimum payments relating to operating leases are as follows:

2005	$ 1,625,607
2006	1,782,717
2007	1,635,789
2008	1,457,325
2009	1,412,651

10. *Financial instruments:*

(a) Interest rate risk:

The Company is exposed to interest rate fluctuations in respect of its long-term debt and drawings under its other bank credit facilities.

(b) Foreign currency risk:

The Company is exposed to foreign currency fluctuations in respect of its operations in the United States.

During 2004 the Company entered into a forward exchange contract, which expired on January 18, 2005 and resulted in a gain of $421,000. The Company elected to not account for this contract as a hedge, as defined under Canadian generally accepted accounting principles, such that it was marked-to-market during the contract period.

The Company recorded net foreign currency gains for the years ended December 31, 2004 and 2003 of $323,929 and $86,948, respectively. The net gain in 2004 reflects the above-mentioned gain on the forward exchange contract less the foreign exchange loss that otherwise occurred.

(c) Credit risk:

The Company's revenue is largely derived from well-established customers such that credit risk is not considered significant. As at December 31, 2004 one client had an outstanding balance of approximately 12 percent of total accounts receivable (2003 – 35 percent).

(d) Fair values:

The fair values of all monetary assets and liabilities at December 31, 2004 approximate their book values due to their short-term to maturity.

11. *Related party transactions:*

The majority of the preferred shares, described in note 7, are held by a company related to the Company's major shareholder. Dividends paid in this regard amounted to $278,905 (2003 - $281,125).

During 2004 fees of $52,545 (2003 - $39,595) were paid to a company related to the Company's major shareholder for accounting services provided.

12. *Segmented information:*

Based on the Company's internal management reporting structure, operating segments have been established for (a) Seismic Processing - reflecting the processing of customers' seismic data - and (b) Data Archiving - reflecting the storage of seismic and other data, in electronic and hard copy formats, with on-line access capabilities. The point of origin of revenues and the location of assets determine the geographic areas.

Industry information:

December 31, 2004	**Seismic Processing**	**Data Archiving**	**Total**
Revenue	$ 14,763,404	$ 6,278,569	$ 21,041,973
Operating expenses	13,285,996	5,045,639	18,331,635
Depreciation and amortization	2,281,250	987,339	3,268,589
Impairment loss	1,060,110	–	1,060,110
Segment earnings (loss)	$ (1,863,952)	$ 245,591	(1,618,361)
Interest			480,586
Loss before income taxes			$ (2,098,947)
Expenditures on property and equipment	$ 1,396,163	$ 560,186	$ 1,956,349
Total assets	$ 11,401,617	$ 4,601,044	$ 16,002,661

December 31, 2003	Seismic Processing	Data Archiving	Total
Revenue	$ 18,845,233	$ 5,725,691	$ 24,570,924
Operating expenses	16,043,505	4,695,659	20,739,164
Depreciation and amortization	2,552,598	1,020,416	3,573,014
Segment earnings (loss)	$ 249,130	$ 9,616	258,746
Interest			600,134
Loss before income taxes			$ (341,388)
Expenditures on property and equipment	$ 2,330,866	$ 674,158	$ 3,005,024
Total assets	$ 15,965,539	$ 5,316,782	$ 21,282,321

Geographic information:

December 31, 2004	**Canada**	**United States**	**Total**
Revenue	**$ 14,986,313**	**$ 6,055,660**	**$ 21,041,973**
Property and equipment	**4,679,161**	**2,837,421**	**7,516,582**
Goodwill	**–**	**–**	**–**

December 31, 2003	Canada	United States	Total
Revenue	$ 15,247,951	$ 9,322,973	$ 24,570,924
Property and equipment	5,156,792	3,535,524	8,692,316
Goodwill	–	1,060,110	1,060,110

During 2004 the Company generated 10 percent (2003 – 10 percent) of its revenue from a single customer.

13. *Comparative figures:*

Certain comparative figures with respect to fiscal 2003 have been reclassified to conform with the current year's presentation.

Corporate Information

Board of Directors

Seymour Epstein [3]
Chairman and CEO,
Epstein Enterprises Inc.

Francis P. McGuire [1]
President and CEO,
Major Drilling Group
International Inc.

Richard F. Miles [1] [2]
President and CEO,
Grant Geophysical

Victor Peters [1] [3]
Lawyer and Businessman

Michael R. Van Every*
Corporate Director

Paul D. Watson [2] [3]
Vice-President, Exploration
Energy 51 Inc.

[1] Member of the Audit Committee
[2] Member of the Compensation Committee
[3] Member of the Corporate Governance Committee
* Effective January 12, 2005

Officers

Seymour Epstein
Chairman of the Board and CEO

Neil S. Baker
Vice-President, Canadian Data Management and Archives

Debbie L. Garbutt
Vice-President, Controller and CFO

Brian H. Link
President, KT International

Patrick J. McKenny
Vice-President, Data Processing

John A. Paul
President and Corporate Secretary

Constantine Tsingas
Vice-President, International

Vivian R. Martin
Assistant Secretary

Registrar and Transfer Agent

CIBC Mellon Trust Company
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Legal Counsel

Fraser Milner Casgrain
Calgary, Alberta

Investor Relations Information

Toronto Stock Exchange
Stock Listing Symbol: **KTI**

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Processing Centre Manager

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Vice-President,
Data Management USA

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Annual Meeting

The Annual and General Meeting of Kelman Technologies, Inc. will be held on May 17, 2005 at 10:00 a.m. in the 2nd floor Auditorium 540 - 5th Avenue S.W., Calgary, Alberta. All Shareholders and interested parties are cordially invited to attend.

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